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PROGRAMME OF WORK OF THE INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING: REVIEW OF IMPORTANT CURRENT DEVELOPMENTS AT THE GLOBAL AND NATIONAL LEVELS IN THE FIELD OF ACCOUNTING AND REPORTING BY TRANSNATIONAL CORPORATIONS, ON THE BASIS OF DOCUMENTATION RECEIVED BY THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS FROM (i) INDIVIDUAL MEMBER STATES, (ii) INTERGOVERNMENTAL ORGANIZATIONS AND (iii) NON-GOVERNMENTAL ORGANIZATIONS

Review of important current developments at the global level in the field of accounting and reporting by transnational corporations

Report of the Secretary-General

SUMMARY

The purpose of this report is to review developments that promote the harmonization of accounting standards worldwide and the comparability of financial statements. Vigorous efforts are under way to reduce the options in international standards and to increase their use by the regulators of securities markets and international trade. At the same time, authorities in Central and Eastern Europe are rewriting their commercial legislation, including accounting regulations, to promote the transition to market economies. Thus, one could optimistically expect significant gains in harmonization during the 1990s. The report also examines certain problem areas: new financial instruments, intangibles, environmental accounting, privatization and accounting for financial institutions. Lastly, the activities of international and regional bodies active in the field are summarized.

* E/C.10/AC.3/1992/1.

CONTENTS

	Paragraphs	Page
INTRODUCTION	1	4
I. MAJOR EFFORTS TO HARMONIZE ACCOUNTING STANDARDS	2 - 28	4
A. The comparability project of the International Accounting Standards Committee (IASC)	9 - 15	6
B. Response to the comparability project	16 - 21	8
C. Changes in commercial legislation in Central and Eastern Europe	22 - 28	10
II. KEY ISSUES IN INTERNATIONAL ACCOUNTING	29 - 59	17
A. New financial instruments (NFI)	30 - 38	17
B. Accounting for intangible assets, including goodwill	39 - 42	19
C. Environmental accounting	43 - 52	20
D. Accounting for financial institutions and the responsibilities of auditors	53 - 58	24
E. Accounting and valuation problems arising during privatization	59	25
III. ACTIVITIES OF INTERNATIONAL AND REGIONAL ORGANIZATIONS	60 - 98	26
A. International Accounting Standards Committee (IASC)	61 - 68	26
B. International Federation of Accountants (IFAC)	69 - 77	28
C. Working Group on Accounting Standards (OECD)	78 - 80	30
D. European Community (EC)	81 - 83	31
E. Confederation of Asian and Pacific Accountants (CAPA)	84	31
F. Eastern, Central and Southern Africa Federation of Accountants (ECSAFA)	85	32

CONTENTS (continued)

		Paragraphs	Page
G.	Fédération des experts comptables européens (FEE)	86 - 93	32
H.	Fédération internationale des experts-comptables francophones (FIDEF)	94 - 96	34
I.	Interamerican Accounting Association (IAA)	97 - 98	35

INTRODUCTION

1. The present report on global accounting issues is divided into three chapters. The first section deals with the harmonization of accounting standards. It covers both the economic events that drive that harmonization and the progress being made at various levels by various organizations. The second section reviews key international accounting issues and/or unresolved problems such as new financial instruments, information disclosure by financial institutions, auditor responsibilities, intangible assets, valuation issues arising during privatization and environmental accounting. The last section summarizes the principal activities of international and regional accounting organizations during 1991.

I. MAJOR EFFORTS TO HARMONIZE ACCOUNTING STANDARDS

2. The need for harmonization continues to be driven by a series of economic events. Some of those events are related and include the globalization of capital markets, the integration of Europe by 1992, the move towards market systems by former command economies and the dismantling of trade barriers and the formation of trade blocs.

3. The market value of all listed companies on the world capital market grew at an annual compound rate of 16 per cent between 1981 and 1990. In 1990 market capitalization reached $9.5 trillion, the number of listed domestic companies totalled 29,068 and the value of traded shares amounted to $6.1 trillion. 1/ Regulators have not kept up with the growth in these markets, and the lag contributes to market volatility since a crisis in one market is quickly transmitted to the others. This lag is ominous given the huge sums that are transferred abroad, the increased importance transnational corporations place on such markets for raising capital and the higher investor risks that come from loosely regulated markets. Investors confront a patchwork of securities laws and inconsistent enforcement policies and diversity in accounting and reporting rules. The level and frequency of public disclosure about corporate finances and ownership is uneven from market to market and accounting standards remain a hodgepodge. 2/

4. In 1991 a working party of the International Organization of Securities Commissions studied the disclosure regimes of 14 countries and found that while the categories of information disclosed were consistent mark-to-market, there were major differences in the specificity of disclosure and the methods by which such disclosures were obtained. Important differences in accounting principles, auditing standards and auditor independence standards existed across countries. The working party concluded that the differences in financial reporting "probably present one of the greatest challenges for issuers seeking to make multinational offerings of securities". 3/

5. The integration of Europe by 1992 has been causing an increase in cross-border activity since transnational corporations want to ensure that they are well positioned in this huge internal market. Foreign listings as percentage of total listings increased during the period 1983-1990 from 26 to 34 per cent in France and from 28 to 46 per cent in Germany. 4/ The annual average foreign direct investment flows into the European Community (EC) doubled between 1980-1984 and 1985-1989 while intra-EC flows increased fourfold in the same period. This growth, which averaged 38 per cent annually (1980-1987), illustrates the acceleration of the integration of the regional economy. In terms of corporate strategy, the increasing importance of intra-EC foreign direct investment can be characterized as the regionalization of EC-owned industry motivated in large part by the 1992 programme to unify the regional market. 5/ This growth will be intensified by the creation of a 19-nation European Economic Area on 1 January 1993 that will include both the European Community and the members of the European Free Trade Association (EFTA). There will therefore be a heightened impetus to harmonize the basic regulatory infrastructure that governs this new expanded market.

6. The rapid move of Central and Eastern Europe to set up market economies, will end not only a 70-year-old ideological battle over the relative efficiency of market versus command economies but also the dichotomy between the respective accounting and reporting systems of those economies. Fortunately, this region has shown a great willingness to adopt and adapt to EC directives and international accounting standards rather than opt for purely national solutions. Association agreements between the European Community and Czechoslovakia, Hungary and Poland are under negotiation. The impact on harmonization will be discussed in a separate section.

7. The dismantling of barriers to trade in goods and services through the current Uruguay Round and through the formation of trading blocs increases global economic activity and exerts pressure for the harmonization of standards or the acceptance of minimum standards. The establishment of a multilateral framework of rules governing trade in services is likely to increase the volume and pattern of cross-border movements in services. Such a framework has been under negotiation in the Uruguay Round of Multilateral Trade Negotiations since 1986. The Group of Negotiations on Services (GNS) has made significant progress regarding a regime that would facilitate the flow of services worldwide. Business services such as accounting, advertising, data processing and software serve foreign markets primarily through the establishment of affiliates or other arrangements that allow for a direct relationship with clients. The multilateral framework emerging from the Uruguay Round could open up national service markets by assuring transparency, progressive liberalization, national treatment, market access and non-discrimination. The aim is to reduce unfair discrimination against foreign service suppliers. There probably will be no special protocol on accounting services and international accounting standards since there is little support for separate rules for different professional services. Accounting services will be taken care of within the General Agreement on Trade and Services (GATS) when it is concluded.

8. Lastly, new trading blocs such as that comprising Canada, Mexico and the United States of America will have an impact on harmonization since these three countries are considering a joint accounting effort as a result of their Free Trade Agreement.

A. The comparability project of the International Accounting Standards Committee (IASC)

9. The International Accounting Standards Committee (IASC) continued to make progress during 1991 in its effort to reduce the number of options in its existing standards. Exposure draft 32, Comparability of Financial Statements (1989), contained 29 proposals that were designed to eliminate most of the choices of accounting treatment for like transactions and events permitted by international accounting standards. That exposure draft received 160 responses and after the review IASC issued a statement of intent that identified:

(a) Twenty-one issues that will be implemented without substantive change from the proposals in ED 32; these issues include IAS 8, Unusual and Prior Period Items and Changes in Accounting Policies; IAS 11, Accounting for Construction Contracts; IAS 16, Accounting for Property, Plant and Equipment; IAS 18, Revenue Recognition; IAS 9, Accounting for Retirement Benefits in the Financial Statements of Employers; IAS 21, Accounting for Effects of Changes in Foreign Exchange Rates; IAS 22, Accounting for Business Combinations; and part of IAS 25, Accounting for Investments. 6/ From the above list, exposure drafts for amendments to IAS 11, 18 and 22 were approved by the IASC Board in November 1991;

(b) Three issues for which the proposals in ED 32 had been changed and which had been re-exposed in 1991. These issues - which include IAS 2, Valuation and Presentation of Inventories in the Context of the Historical Cost System, which is replaced by E 38; IAS 9, Accounting for Research and Development Activities, which is replaced by E 37; and IAS 23, Capitalization of Borrowing Costs, which is replaced by E 39 - are discussed below;

(c) Five issues of which further consideration has been deferred pending work on other projects, notably financial instruments; these issues include IAS 17, Accounting for Leases, and part of IAS 25, Accounting for Investments.

Development costs

10. ED 32 proposed that development costs should be recognized as an expense when incurred (benchmark treatment) or capitalized when certain criteria are met (allowed alternative treatment). A substantial number of commentators on ED 32 argued that development costs that meet the asset recognition criteria in the Framework for the Preparation and Presentation of Financial Statements should be recognized as assets. They believed that it would be inconsistent for such costs to be written off as incurred and that in those circumstances enterprises should not be permitted a free choice between deferral and immediate write-off.

11. ED 37 proposes that development costs of a project should be recognized as an asset when: (a) the product or process is clearly defined and the costs attributable to the project or process can be identified separately and measured reliably and (b) all the following criteria are satisfied:

(i) The technical feasibility of the product or process is reasonably assured;

(ii) The enterprise intends to produce and market, or use, the product or process;

(iii) The existence of a market for the product or process or, if it is to be used internally rather than sold, its usefulness to the enterprise is reasonably assured;

(iv) Adequate resources exist, or are reasonably assured to be available, to complete the project and market or use the product or process.

In all other instances research and development costs should be recognized as an expense only.

Inventories

12. ED 38 proposes that inventories should be measured at the lower of historical cost and net realizable value. Inventories that are not ordinarily interchangeable or goods manufactured and segregated for specific projects should be accounted for using specific identification of their individual costs. The weighted-average cost formula or the first in, first out formula (FIFO) should be used for assigning costs to all other inventories. As set out in the ED 32 statement of intent, the last in, first out formula (LIFO) and base stock formula may not be used. Originally, ED 32 allowed LIFO as an alternative treatment but many commentators on ED 32 argued that the use of LIFO should not be permitted because (a) fiscal considerations unique to particular countries do not provide an adequate conceptual basis for selecting appropriate accounting treatments and (b) it is inconsistent to retain LIFO in a historical cost context as a partial attempt to account for the effects of changing prices without introducing other changes to provide a more comprehensive method of inflation accounting. The proposed statement specifically excludes producer inventories of agricultural products.

Borrowing costs

13. Originally ED 32 proposed that borrowing costs should be recognized as an expense when incurred (benchmark treatment) or capitalized when certain criteria are met (allowed alternative). A number of respondents criticized the proposed benchmark treatment because borrowing costs incurred to generate future income meet the Framework definition of an asset.

14. ED 39 proposes that borrowing costs should be recognized as part of the cost of assets when specified criteria are met. All other borrowing costs are recognized as an expense in the period in which they are incurred. Assets on which borrowing costs should be capitalized may include property, plant and equipment, investment properties and, in certain circumstances, inventories. The amount of borrowing costs capitalized by an enterprise during the period is limited to the total amount of borrowing costs incurred, less interest income earned. This proposal is at variance with existing standards in certain countries.

15. A number of exposure drafts were approved by the IASC Board in November 1991. They deal with Construction Contracts (IAS 11), Revenue Recognition (IAS 18) and Business Combinations (IAS 22).

B. Response to the comparability project

16. Transparency and comparability of financial information can be achieved through two different approaches. 7/ One approach favours a system of reciprocity based on some substantially equivalent minimum threshold where countries with similar standards mutually recognize each other's standards as a condition for market access. An example of that approach is the Canadian-American multijurisdictional disclosure system, which allows cross-border securities offerings, take-over bids and issuer bids by allowing transactions to proceed on the basis of home country disclosures and rules. 8/ A similar agreement is being worked out with the United Kingdom of Great Britain and Northern Ireland.

17. The other approach favours the adoption of a common set of disclosure and accounting standards such as the European Community directives and/or international accounting standards. The European Community has recently shifted towards the approach of minimum harmonization and mutual recognition after deciding that its earlier approach of detailed harmonization had not worked. If the Community had continued to pursue detailed harmonization, some experts felt, the appropriate conditions for a single market would have never been created. Therefore, the European Community has changed its approach to one based on minimum standards and mutual recognition and is at the same time supporting international harmonization and participating in the IASC comparability project. 9/

18. The Fédération des experts comptables européens (FEE) has taken the position that mutual recognition may facilitate the growth and integration of capital markets by reducing the burden of enterprises of preparing different sets of accounts or reconciliations in order to be listed on foreign exchanges. As part of mutual recognition, however, it is important that minimum standards are agreed upon that ensure a minimum acceptable level of quality. Consequently, FEE recommends that as a basis for mutual recognition a minimum set of internationally accepted standards should be agreed upon in order to ensure an acceptable quality of presentation and disclosure of financial information in accounts.

19. It is the intention of the International Organization of Securities Commissions (IOSCO) to require that enterprises seeking listings on the various exchanges use international accounting standards once the IASC comparability project is complete. With this in mind IOSCO asked IASC to also revise IAS 14, Reporting Financial Information by Segment, and IAS 24, Related Party Disclosures.

20. Recently, the Financial Accounting Standards Board (FASB) (United States) has become interested in international accounting matters, largely as the result of the explosive growth of cross-border financing and investing that shifted the focus from national to international comparability. Its objective is to achieve greater consistency between American accounting standards and those promulgated by other national bodies and IASC. According to its strategic plan for international activities FASB will:

(a) Intensify consideration of foreign national and IASC standards in all domestically oriented FASB projects;

(b) Engage in joint multinational standard-setting projects on commonly selected topics with the objective of arriving at separate national standards that are in substantial agreement with one another and with IASC standards;

(c) Consider adopting foreign national or IASC standards that are judged through due process to be superior to their American counterparts. The focus will be on IASC benchmark standards if a pronouncement permits alternative methods;

(d) Try to convince other countries or IASC to adopt specific American standards that are judged through due process to be superior to their foreign national or international counterparts;

(e) Attempt to reach agreement on a choice of existing standards where neither the American nor other national or IASC standards are demonstrably superior;

(f) Continue efforts to encourage equality of financial statement requirements for foreign and domestic companies in their utilization of American capital markets. 10/

21. Besides the efforts of international, regional and national accounting bodies to promote harmonization, transnational corporations themselves are starting to use international standards particularly when the standards of their home countries are not fully developed and/or regional standards are lacking in detail. Due to increasing competitive market pressures, transnational corporations are voluntarily disclosing information that they hope will help them to raise funds more cheaply and promote their capacity to engage in merger and investment activity. In Switzerland a number of corporations such as ASEA-Brown Boveri, Ltd., Ciba-Geigy, Hoffmann-La Roche, Holderbank Financière Glaris, Ltd., Landis & Gyr, Nestle and Sandoz are bringing, or are making preparations to bring, their accounts into line with

international accounting standards. For several years, Italy's Commissione Nazionale per le Società a la Borsa (CONSOB) has required that listed companies apply international accounting standards when no national standard exists. Canada, Zimbabwe and other countries also expect listed companies to comply with international accounting standards.

C. Changes in commercial legislation in Central and Eastern Europe

22. As discussed last year there has been no greater force for harmonization of accounting practices than the move of the former command economies towards market systems. Over the past year Central and Eastern European countries have adopted the necessary commercial legislation to create the conditions and infrastructure for a free market system. This includes legislation on accounting, banking, company law, free trade zones, foreign exchange and financial transactions, foreign direct investment, joint-stock companies, privatization and taxation, to name just a few areas.

23. Legal barriers to the establishment and operation of private enterprises, particularly joint-stock companies, have been swept away. Foreign investors, who were formerly confined to joint ventures, are now allowed either to participate in joint-stock companies or to set up wholly owned enterprises. The foreign purchase of equity shares is likely to replace the traditional foreign contribution to the statutory capital of joint ventures as the principal vehicle for inward foreign direct investment (FDI). A highly restrictive environment has given way to a very fluid one in which the commercial rules are constantly being rethought and changed. This creates its own difficulties and uncertainties for both domestic and foreign investors who have a hard time keeping up with the latest developments. The table lists the most recent laws in three areas of concern: accounting, foreign direct investment and privatization. It is often difficult to procure the texts of new laws as they are not always published in official gazettes and sometimes various versions are issued by those gazettes.

24. Foreign investors have been pressing for an overhaul of accounting regulations so that Eastern accounting practices can be brought into line with Western practices. Bulgaria, Czechoslovakia, Hungary, Poland, Romania and the Union of Soviet Socialist Republics have revised their accounting regulations and four of the six have passed comprehensive accounting laws. The report of the Secretary-General on national developments will give a detailed analysis of these laws. In general Czechoslovakia, Hungary and Poland have modelled their reforms on the EC directives while still retaining a modified chart of accounts for enterprises. The new laws replace a system of "compliance" reporting with one designed to give a true and fair view of operations. The preamble to the Hungarian accounting law explains that that law creates the legal framework whereby accounting will provide a true and fair view of the financial position and performance of enterprises in line with international standards. The enactment of these reforms into law is a powerful force for global harmonization.

Table. Recent selected laws and decrees on foreign direct investment, privatization and accounting and auditing in Central and Eastern Europe

Country or area	Law or decree
Albania	Decree No. 7406 by the Presidium of the People's Assembly of Albania, 31 July 1990, on the Protection of Foreign Investment
	Decree No. 7407, 21 July 1990, on the economic activity of enterprises with the Participation of Foreign Capital
	Decree No. 7512, 10 August 1991, on Sanctioning and Protection of Private Property, Free Initiative of Independent Private Activities and Privatization
Bulgaria	Decree No. 56, 9 January 1989, on Economic Activity as amended in December 1990
	Regulation of 15 February 1989 on the application of Decree No. 56
	Foreign Investment Law, May 1991
	Company Law, 15 May 1991
	Law on Accounting, 3 January 1991
Czechoslovakia	Act on Economic Relations with Foreign Countries (1980) (Act No. 42/1980, in the working of Act No. 112/1988) as amended in 1990 (Act No. 113/1990)
	Act on Enterprises with Foreign Property Participation (1988) (Act No. 173/1988), as amended in 1990 (Act No. 112/1990)
	Act on Joint-Stock Companies, 18 April 1990 (Act No. 104/1990)
	Law on the Privatization of State Ownership of Certain Property to Other Legal or Natural Persons, 25 October 1990
	Law on the Terms of Transfer of State Property to Other Persons, 26 February 1991

Table. Recent selected laws and decrees on foreign direct investment, privatization and accounting and auditing in Central and Eastern Europe (continued)

Country or area	Law or decree
Hungary	Act No. VI of 1988 on Economic Associations
	Act No. XXIV of 1988 on the Investment of Foreigners in Hungary as amended
	Act No. XIII of 1989 on the Transformation of Economic Organizations and Business Associations
	Act XCVIII of 1991: Amendments of Act XXIV of 1988 on the Investment by Foreigners in Hungary
	Law No. 5 of 1990 on Private Business Ventures
	Law No. 6 of 1990 on Stock Exchanges and Securities
	Law No. 7 of 1990 on the State Property Agency
	Law No. 9 of 1990 on the Protection of Assets of the State-Owned Companies
	Law No. 53 of 1990 on the Amendment of the Law on State Property Agency (Law No. 7 of 1990)
	Law No. 74 of 1990 on Privatization of the Small Trade Services and Catering Industry
	Decree No. 63 of the Council of Ministers on the Local Property Agencies
	Decree No. 30, 1989 (VII-I) on Property in the Balance Sheet
	Act No. XVIII of 14 May 1991 on Accounting (effective January 1992)
Lithuania	Law on Foreign Investment in the Republic of Lithuania of 29 December 1990
	Decree of Finance Ministry on Accountancy by Legal Persons and Other Economic Entities, 1 January 1991

Table. Recent selected laws and decrees on foreign direct investment, privatization and accounting and auditing in Central and Eastern Europe (continued)

Country or area	Law or decree
Poland	Law on Economic Activity with the Participation of Foreign Parties of 23 December 1988 (Dziennik Ustaw No. 1, item 325), as amended on 23 December 1989
	Law on the Privatization of State Enterprises of 13 July 1990 (Dziennik Ustaw No. 51, item 298)
	Law on the Creation of the Office of the Minister of Ownership Transformation, 13 July 1990
	Law on Companies with Foreign Participation, 14 June 1991
Romania	Decree Law No. 54 on the Organization and Development of Economic Activities Based on Free Initiative, 5 February 1990
	Decree Law No. 96 concerning Measures for Attracting Foreign Capital Investment to Romania, 14 March 1990
	Decree Law No. 122 on the Authorization and Functioning in Romania of Representations for Foreign Trade Companies and Economic Organizations, 24 April 1990
	Law on Commercial Companies of 16 November 1990 (No. 31/1990)
	Law on Restructuring State Economic Units as Autonomous Units and Commercial Companies of 31 July 1990
	Law on Privatization of Companies, 16 August 1991
	Law Concerning the Status of Foreign Investment, 29 March 1991
	Decree Law No. 201/1990, implementing No. 54 and giving rules for Preparation and Standardization of Accounts, a Model Balance Sheet and Chart of Accounts
	Decree Law No. 945/90 on Accounting Practices for Share Capital, Assets, Liabilities, Changes in the Chart of Accounts, Content and Operation of New Accounts
	Law 31/91 on the Balance Sheet and Income Statement

Table. Recent selected laws and decrees on foreign direct investment, privatization and accounting and auditing in Central and Eastern Europe (continued)

Country or area	Law or decree
Yugoslavia	Law on Foreign Investment, 31 December 1988
	Law on Securities of 20 October 1989
	Money Market and Capital Market Law of 20 October 1989
USSR	Decree of the Council of Ministers of the USSR, 13 January 1987 (49/1987) on Joint Ventures with the Participation of Soviet Organizations and Companies from Capitalist or Developing Countries
	Decree of the Council of Ministers of the USSR, 19 June 1990 (No. 590/1990), on Joint-Stock and Limited Liability Companies
	Presidential Decree of 26 October 1990 on Foreign Investment in the Soviet Union
	Law on Enterprises, 1 January 1991
	Law on Fundamentals of Legislation on Investment Activities, 1 January 1991
	Law on Fundamentals of Denationalization and Privatization of Enterprises, USSR Supreme Soviet, 1 July 1991
	Law on Fundamentals of Legislation on Foreign Investments in the USSR, USSR Supreme Soviet, 5 July 1991
	Circular No. 53/13-09, USSR Ministry of Finance and Central Board of Statistics, on Accounting and Bookkeeping of Joint Ventures, 27 February 1987; amended 8 August 1989
	Directive No. 74 of the USSR Ministry of Finance, Accounting Regulations for Joint Ventures, 6 June 1990
	USSR Ministry of Finance, Accounting and Reporting by Enterprises, Associations and Organizations, 12 October 1990
	USSR Ministry of Finance, USSR State Plan, USSR State Committee on Prices and USSR State Committee on Statistics: Basic Provisions to Determine the Expenses to be Included in the Cost Price of Products at Enterprises of the USSR, 30 November 1990

Table. Recent selected laws and decrees on foreign direct investment, privatization and accounting and auditing in Central and Eastern Europe (continued)

Country or area	Law or decree
USSR (continued)	Directive No. 142, USSR Ministry of Finance, on Special Features of the Calculation of the Costs of Production (Works, Services) of Joint Ventures Established in the USSR, 29 December 1990
	USSR Ministry of Finance, Scope and Methods of Annual Accounting and Reporting in Enterprises, Associations and Organizations for 1991, 17 June 1991
Russian republic	Law of the RSFSR on Enterprises and on Business Activity, 25 December 1990
	Law on Foreign Investments, 4 July 1991
	Law on Privatization of State and Municipal Enterprises, 3 July 1991
Kazakhstan	Law on Foreign Investment, effective 17 January 1991
	Law on Freedom of Economic Activities and Development of Business Undertakings Within the Kazakh SSR, 15 January 1991
	Law on Basic Principles of Kazakh SSR Foreign Economic Activities, 17 January 1991
Uzbekistan	Law on Business Undertakings in the Uzbek SSR, USSR Supreme Soviet, 15 February 1991
	Law on Enterprises in the Uzbek SSR, USSR Supreme Soviet, 15 February 1991
	Law on Foreign Investment in the Uzbek SSR, USSR Supreme Soviet, 14 June 1991
Ukraine	Law on Economic Independence
	Law on Foreign Economic Activity
	Law on Foreign Investment

25. Using international accounting standards as far as possible the USSR completed modernization of its chart of accounts, which was approved by the USSR Ministry of Finance for use by all enterprises. It will be disseminated to all republics and some have expressed interest in taking it over in order to speed their transition to a market economy. However, the fact that some foreign investment legislation at the republic level allows foreign investors to use their home country accounting rules will lead to a duality in practices depending on whether the enterprise in question is domestic or foreign.

26. Advice on accounting reform is being given by accounting experts from every quarter, including individual consultants, national teams, regional teams and international teams. The Organisation for Economic Cooperation and Development has held two meetings, one in September 1990 to discuss general issues in East-West accounting and one (with FEE) in November 1991 to discuss privatization issues. FEE has developed an accounting and auditing project for Bulgaria and also organized a conference (in Budapest in October 1991) with the Council of Europe on the role of the accountancy profession. The activities of FEE in this sphere demonstrate the willingness of its members to work together in the interests of Europe as a whole rather than pursue national interests. The United Nations Centre on Transnational Corporations (UNCTC) has also taken an international approach and has involved a number of international experts from the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), the International Federation of Accountants and the international accounting firms in its task force in the USSR.

27. Technical cooperation projects in accounting will increase as more funding becomes available from international, regional and national sources. Donors might wish to ensure that those involved in such projects have a basic knowledge of former accounting systems and the legal, political and social environment within which Eastern accountants must function. It is important that foreign experts realize that the former system, which was very detailed, must be replaced by one that not only is detailed but also gives adequate guidance on the use of new procedures. This is largely because Eastern accountants and bookkeepers (given the long period of isolation they have endured) are simply not in a position to implement a system that requires constant judgements as to the appropriate accounting treatment. The new accounting and draft laws of Central and Eastern Europe vary in terms of detail and guidance given, in particular the Hungarian law and the draft chart of accounts of the USSR (which are both very long and complete) and the Czech and Polish laws (which are very short). Since those laws do not address many issues, it will be difficult to ensure comparability in practice at the enterprise level. Hopefully additional guidance will be issued in order to facilitate uniform treatment.

28. It is also important that international, regional and national donors and experts exchange information on a periodic basis so that their efforts complement each other's and are not at cross purposes. A situation where efforts were at cross purposes would make an already chaotic situation worse. The Group may wish to discuss the responsibilities of the international community in this context.

II. KEY ISSUES IN INTERNATIONAL ACCOUNTING

29. The present section reviews progress being made on key issues or problems in international accounting. Many of the issues are complex and continue to defy agreement on the proper accounting treatment. There are three continuing topics - new financial instruments, intangible assets and environmental accounting - and three new topics: accounting by financial institutions, the responsibilities of auditors and valuation problems in privatization.

A. New financial instruments (NFI)

30. The Group has had the present topic under review since its seventh session and the main issues were explored in E/C.10/AC.3/1990/9 and E/C.10/AC.3/1991/2. The International Accounting Standards Committee (IASC) published ED 40, Financial Instruments, in August 1991. The exposure draft follows the structure of the previous statement of principles and deals with:

(a) Recognition of financial assets and liabilities and discontinuing recognition;

(b) Classification as a liability or as equity;

(c) Measurement;

(d) Disclosure.

31. It is intended that the proposals be applied to all enterprises, not just financial institutions. The exposure draft proposes that a financial asset or liability should be recognized in the balance sheet when the risks and rewards associated with that asset or liability have been assumed and the asset or liability can be reliably measured. Recognition ceases when these conditions no longer exist, for example, on transfer, exercise, discharge, cancellation or expiry of the underlying rights or obligations.

32. For purposes of balance sheet presentation, the exposure draft proposes that the classification of a financial instrument as either a liability or equity should be based on the substance of the instrument in relation to the definitions of financial liability and equity instrument. When the instrument commits the issuer to deliver cash or other financial assets to the holder in repayment of the principal amount, it should be classified as a liability. The proposals also set out criteria for offsetting a financial asset and a financial liability and reporting only the net amount. Each financial instrument should be classified in one of three categories: investing or financing (for items held for the long term), operating (for items not intended to be held for the long term and not designated as hedges) and hedging.

33. Under the benchmark treatment, investing and financing assets and liabilities are measured on a historical cost basis. A financial asset's carrying amount is written down when there is no persuasive evidence that it will be recoverable in the foreseeable future. This decline should be reversed when there is a recovery in the value of the asset that is likely to persist. Operating assets and liabilities are measured at fair value; changes in fair value are recognized in income as they arise. Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's-length transaction. Hedging items are measured on the same basis as the positions that they hedge.

34. Under the allowed alternative treatment, all financial assets and liabilities are measured at fair value, provided that it is practicable to do so; changes in fair value are recognized in income as they arise. Developing-country experts mentioned that the split into long-term instruments (investments) and short-term instruments (operating instruments) might be difficult since the decision to hold an instrument is tentative and can be judged final only ex post facto. In addition, many developing countries that do not have well-developed primary/secondary money markets may find reliable fair-value valuation of new financial instruments very difficult. Thus, it seems more practical to support the proposal to use historical costs for both long-term and short-term financial instruments, but to require disclosure at fair-market value for all new financial instruments whenever possible.

35. To assist users of financial statements in understanding how transactions in financial instruments affect the amount, timing and certainty of future cash flows, the proposals require a number of disclosures, grouped by appropriate classes of instruments, including:

(a) The nature, extent, terms and conditions of the instruments;

(b) The exposure to interest rate risk, including contractual repricing or maturity dates and effective interest rates;

(c) The exposure to credit risk, including maximum exposure, ignoring the value of any collateral and any concentrations of credit risk;

(d) Information about the fair value of assets carried on a historical cost basis.

36. The exposure draft has been developed in conjunction with the Accounting Standards Committee of the Canadian Institute of Chartered Accountants, which published a similar exposure draft at the same time. The Canadian exposure draft does not include the allowed alternative for the measurement of financial assets and financial liabilities.

37. The Financial Accounting Standards Board in the United States has completed the first phase of its project on new financial instruments and has issued Statement of Financial Accounting Standard No. 105: Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk in 1990.

38. This statement establishes the following requirements for all entities for disclosure of information principally about financial instruments with off-balance-sheet risk of accounting loss:

(a) The face, contract, or notional principal amount;

(b) The nature and terms of the instruments and a discussion of their credit and market risk, cash requirements and related accounting policies;

(c) The accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract, and the collateral or other security, if any, for the amount due proved to be of no value to the entity;

(d) The entity's policy for requiring collateral or other security on financial instruments that it accepts and a description of collateral on instruments presently held.

This Statement also requires disclosure of information about significant concentrations of credit risk from an individual counterparty or groups of counterparties for all financial instruments. FASB has also issued discussion memoranda on different aspects of its financial instruments projects, and further exposure drafts and statements are anticipated.

B. Accounting for intangible assets, including goodwill

39. OECD continued its work on intangible assets and held a round table in May 1991 to determine if the various national standard-setters were any closer to reaching consensus on an international standard on accounting for intangible assets. The growing importance of intangible assets to the successful conduct of business in a variety of industries accentuates the need for guidance on appropriate accounting treatments. 11/

40. According to one financial analyst the solutions are difficult because of a fundamental conflict with one purpose of Western accounting - the recording of actual transactions. Purchased goodwill has to be recorded and accounted for in so far as a transaction has taken place. However, some financial analysts would rather not have purchased goodwill recorded because the purpose of a balance sheet is not to reflect present value of future earnings, but rather values of assets. The concept of goodwill is related to the difference between book value of net assets and market value of the business, but analysts would rather not have goodwill on the balance sheet. 12/

41. While internally generated goodwill is not recognized by any country, other internally generated intangibles, such as patents, trade marks and licences, are normally given recognition. While research and development expenditures can be recognized as an intangible asset, in most countries such recognition is often restricted to development costs, provided criteria concerning the viability of the project are met. A variety of treatments are

applied to the measurement of intangibles, but when purchased intangibles are generally accepted as assets subject to amortization. However, in some countries it is possible to treat these items as assets without amortization, in other words, a finite life for such assets is not assumed. Only Switzerland and the United Kingdom of Great Britain and Northern Ireland allow immediate write-off against reserves of all intangible assets. France, Germany, Italy, Luxembourg and Sweden allow immediate write-off only in the case of goodwill, which conforms to the EC directives; however, the IASC ED 32 proposals would eliminate the immediate write-off method altogether. Another area of accounting diversity is the length of time for amortization. That length of time either arbitrarily ranges from 5 to 40 years or comprises the asset's "useful economic life". The latter approach is supported by the EC directives and IASC E 37, Research and Development Activities. 13/

42. The IASC ED 32 proposal to amend IAS 22 on accounting for business combinations would require a uniform treatment of purchased goodwill. Goodwill arising on a business combination should be recognized as an asset and amortized over its useful life. The amortization period should not exceed 5 years from the date of the acquisition unless a longer period, not exceeding 20 years, can be justified. IASC is continuing its research on this topic and has not published anything subsequent to its proposed statement of principles on accounting for long-term intangible assets, which was considered by the IASC Board in November 1990. Intangible assets covered by the statement included computer software, copyrights, know-how, franchises, licences, patents, publishing rights, brand names, trade marks and customer lists. Excluded from the statement were goodwill arising on business combinations and research and development costs. Criteria were proposed for recognition and de-recognition, and it was suggested that they be measured at historical cost and amortized over a period not exceeding 5 years unless a longer useful life that should not exceed 20 years could be justified. This choice was based on IASC's perception that asset lives "although possibly indeterminate, are ultimately finite". Subsequent to issuing this statement the IASC set up a separate project on long-term intangible assets. FASB has just issued a discussion memorandum on consolidations that is relevant to business combinations. Furthermore, the United States has a proposal to allow tax deductibility of goodwill in the same manner as other intangibles. The Accounting Standards Board of the United Kingdom is also expected to reconsider all intangibles. Moreover, as consolidations become more prevalent the area is expected to gain greater attention.

C. Environmental accounting

43. There is fairly widespread concern among accountants, auditors, regulators, insurance companies, banks and shareholders about the lack of information disclosure regarding the environmental expenditures and liabilities of enterprises operating in sectors with significant environmental impacts. Despite increased guidance by a number of international and national bodies, the information given remains anecdotal and does not allow one to determine the impact of environmental protection measures on the financial

position and performance of the enterprise even when that impact is material. It is estimated that at least $675 billion will be required to clean up existing "Superfund" landfill sites in the United States. Costs for sites cleaned so far have ranged from $20 million to $40 million per site. In Western Europe, the clean-up bill is expected to be at least $65 billion, and in Eastern Europe, the environmental damage has yet to be quantified. These are just a few examples to illustrate that new kinds of liabilities are being created and that the frequency and magnitude of some liabilities that were minor in the past may be increasing rapidly. All in all, the world is now likely to be facing at least a trillion dollar environmental obligation. 14/

44. The Investor Responsibility Research Centre did an extensive examination of the 10K Standard & Poor's 500 companies and found that 36 more companies mentioned the environment in their 10Ks in 1989 than in 1988. This increase was in response to a May 1989 release in which the United States Securities and Exchange Commission (SEC) explained how corporations should address liabilities in Management's Discussion and Analysis of Financial Condition and Results of Operations. In total, 327 of the 500 companies provided disclosure in 1989. One hundred ten provided disclosure on environmental expenditures; 117 disclosed some information about their Superfund status and 114 disclosed government proceedings related to the environment. The level of detail in the information disclosed was generally very low. Though SEC requires disclosure of all material environmental expenses, it does not regulate the format that companies use to present those expenditures. As a result, there is little consistency in the way companies describe their environmental expenses. The Securities and Exchange Commission has found it necessary to seek an information-exchange agreement with the Environmental Protection Agency so that it can identify inadequate or incorrect corporate statements. 15/

45. Price Waterhouse also undertook a survey of corporate accounting practices in reporting the costs of past, present and future activities related to the environment. The report offered guidelines to improve the structure and consistency in accounting for environmental costs. It should be noted that the survey (of 125 companies) focused on <u>when</u> they reported, not on what they reported or how. One hundred and four respondents said that they assigned responsibility for environmental affairs to the legal department and possibly indicated that their main concern was their legal responsibilities. Fifty-three per cent of respondents stated that they recorded environmental liabilities for prior-period waste only after a settlement offer was made by the company, it was actually being cleaned up or when a facility was sold, disposed of or abandoned. Sixty-eight per cent of respondents indicated that they did not accrue currently for future environmental expenditures for reclamation, waste water pond closure and the ultimate closure of production sites. In commenting on this unwillingness to accrue, Price Waterhouse said,

> "Price Waterhouse believes that as environmental regulations evolve in the 1990s corporate concern for the cost of complying with those regulations will significantly increase. As a result, accruing currently for determinable future obligations may become a more common practice." 16/

46. During its ninth session the Group noted that there seemed to be a growing awareness of the need for better information disclosure and it was suggested that the Group continue to review the content of the reports of the Board of Directors. There was also a need to encourage others to start or continue work in the area of environmental accounting. In responding to these suggestions, the United Nations Centre on Transnational Corporations undertook a review of the annual reports of 200 transnational corporations and compared the typical best practice with the Secretary-General's benchmark recommendations. The survey covered the disclosure of relevant environmental issues and policies, environmental improvements, emission targets, impact of government legislation, proceedings under environmental laws, financial effects of environmental protection measures, operating costs and amount of costs capitalized. The results of this work are discussed in E/C.10/AC.3/1992/3.

47. In addition, the Centre put together an environmental accounting bibliography, which should facilitate the research of others in the field. The bibliography contains an essay on the main issues, an abstract of major writings and a complete listing of all books and articles by category.

48. The Commission of the European Communities has been addressing the general topic of environmental reporting for some time. Recently the decision was taken to address that topic also in the accounting area. The fifth action programme on the environment intends to look at ways and means to take action on the following issues:

(a) What information about the environmental policy and activities of an enterprise should be disclosed in its annual report;

(b) How an enterprise has to account for contingent environmental liabilities;

(c) How expenses on environmental programmes have to be defined, should an enterprise have to disclose those expenses, in order to separate them from other expenses.

Those three issues cover many of the items on the list of recommendations of the Group. Thus, although there have been no disclosure requirements or recommendations for the items as yet, it is conceivable that at the community level such requirements or recommendations will be issued. The extent and amount of detail of the data remain to be decided upon.

49. The European Community (EC) has agreed on plans for a system of voluntary audits by companies on how their activities affect the environment. Each European Community country would set up a register of companies carrying out an eco-audit and appoint one independent body to accredit the eco-auditors. Companies taking part and conforming to the EC-agreed green auditing norms would be entitled to use a logo on their annual reports, letterheads and advertising. The European Community plans to issue a regulation by the end of 1992; the system would come into operation by 1993. This means that member

countries will have to develop professional qualifications and accreditations for environmental auditors.

50. The Canadian Institute of Chartered Accountants (CICA), the Institute of Chartered Accountants in England and Wales and the United States Financial Accounting Standards Board have begun projects or are considering proposals on environmental accounting. CICA will complete two reports on environmental accounting and environmental auditing in mid-1992 and has also set up a strategy-steering group to discuss what the accounting profession should be doing. The Institute of Chartered Accountants in England and Wales is aiming to complete its study in 1992. The study is being undertaken by a multidisciplinary group that is examining resolved and unresolved issues. The work has a very practical orientation and where agreement is found on the treatment for a problem and the group is also in agreement the practice will be commended. This topic will also be discussed at the World Congress of Accountants.

51. Preparations for the United Nations Conference on Environment and Development, to be held in Brazil in June 1992, are under way. The Preparatory Committee for the United Nations Conference on Environment and Development has received several contributions on environmental accounting at both the macro and the micro levels. This work focuses in particular on accounting for sustainable development, which goes much beyond the work being done to improve environmental information disclosure in financial statements and annual reports. The main focus of the UNCTC project on accounting for sustainable development is to help transnational corporations develop better tools, particularly in the area of financial management, so that they can become better stewards. Although current accounting practices record "market" transactions that have a monetary value, they do not account for the use of public goods such as air and water because these are largely "free" goods. Accounting for sustainable development would include the full cost of the enterprise's use of natural and environmental resources whether or not a market transaction occurred. This internalization of all the environmental costs would have an impact on the enterprise's bottom line. New accounting rules and prototype statements would have to be developed for the inclusion of these costs. In addition, new valuation methods for quantifying the unrecorded costs of non-sustainable development would have to be devised. This would require the redefinition of asset and liability boundaries, including quantification of the extent of resource depletion and degradation due to a given enterprise's activities. A key output of this project will be a set of resource-based accounts that measure an enterprise's use and management of environmental capital. 17/

52. It must be admitted that such work is at present very far removed from mainstream corporate concerns. Sir Peter Parkers, Chairman of the British Institute of Management, notes that "the definition of sustainable development is still likely to prove elusive for a harassed management dealing with problems of profit, jobs and shareholders". Nevertheless, other groups have undertaken similar projects and the Business Council for Sustainable Development (Geneva) is creating a framework for corporate reporting on

sustainable development that would require a given enterprise to do the following: (a) develop a policy on sustainable development, (b) assign responsibility for its implementation, (c) set up a system for achieving that policy, (d) monitor the system and (e) report on the policy's results.

D. Accounting for financial institutions and the responsibilities of auditors

53. The Group, since its inception, has consistently deferred consideration of accounting for financial institutions. Given recent experiences on the national and international level, the Group may wish to give guidance in the future. It became obvious during the course of 1991 that bank regulators along with accountants and auditors have not kept pace with the growing complexity of international finance and in particular with the activities of transnational banks. The key to successful bank regulation is knowing that assets and liabilities are fairly stated. Lack of information disclosure on bank structure and on related party transactions makes regulation of transnational banks such as the Bank of Credit and Commerce International (BCCI) difficult. The main regulatory body at the international level is the Basel Committee on Banking Regulations and Supervisory Practices, which is composed of central bankers and bank supervisors. The Basel Concordat (1975; amended, 1983) laid down the division of responsibility between bank supervisors in the home country and in the host country of a transnational bank and also established rules for supervision on a consolidated basis, covering a banking group as a whole, and standards for capital adequacy. Its main concern has been capital adequacy and it has established a minimum capital/asset ratio of 8 per cent. However, without adequate knowledge of bank structure and related party transactions, it is difficult to enforce such a minimum rule.

54. As at 31 December 1989, the BCCI group was composed of 34 banking units/finance companies in 73 countries with over 423 offices with more than 14,000 employees of 83 nationalities (including over 200 executives with experience averaging 20 years or more). The group had 1.3 million customers (of which 250,000 were borrowing customers and 3,000 were core customers) and an asset base of $23.5 billion, which included $7.8 billion in United States dollars and the balance of $15.7 billion in 52 local currencies of the countries where BCCI operated.

55. BCCI reportedly maintained nearly 50 per cent liquidity compared to 15-20 per cent for most transnational banks and had fixed assets of $246 million and investment in non-consolidated subsidiaries of $65 million (including units in Switzerland and Kuwait). Each country unit was operating on a self-sufficient basis, duly regulated and audited up to the year ending 1988/1989.

56. It was a substantial net placer of funds in the international market (having borrowed $3.2 billion and placed $9 billion). This transnational bank had become one of the 10 largest banking networks: it handled global trade of

$20 billion and provided a bridge between the markets of the developed and developing world. With the expected liberalization of trade in services as a result of the Uruguay Round and deregulation, it is most likely that more transnational banks will emerge in developing countries and that they will inevitably need regulation. Such regulation might be accomplished through international bank standards.

57. In the absence of effective international standards, BCCI's founder split the bank into dozens of small components so that no one regulator or auditor managed to put together the picture of its diverse structure for over a decade. Its main operations were carried out in weak jurisdictions with strict bank secrecy laws. In addition, its audit was split between two international firms. The college of regulators from eight countries, formed by the Basel Committee to oversee BCCI, was ineffective, with BCCI not owing a consolidated report to anyone. BCCI began to attract attention in 1985 when it incurred huge losses on its financial trading. The auditors also noticed that BCCI had not properly recorded those losses but dismissed the mistake as incompetence rather than fraud. However, by 1988 a sole auditor had been appointed and by the spring of 1990 that auditor had evidence of fraud. Nevertheless, it chose not to qualify its report and warn shareholders that the accounts did not present a true and fair view of BCCI's financial position and performance, although it did avail itself of its legal right to warn national bank regulators.

58. It was a full year later when the auditor was asked by a national bank regulator to begin an investigation. It allegedly found that BCCI was responsible for one of the most complex deceptions in banking history with its sham loans, unrecorded deposits, secret files and illicit share-buying schemes. One government authority, in commenting on the affair said, "... the rapid move to the global market makes this parochialism more and more an unsatisfactory indulgence. ... Sometimes individual subsidiaries in individual countries can look strong but the group structure reveals cross-holdings and cross-lending which is in practice weak". 18/ It is clear that there is a need for an international standard for transnational bank accounting and auditing that has a strong requirement for information disclosure. There is also a need for international cooperation to set, and collectively enforce, such a standard. Lastly, the legal and professional responsibilities of the auditors should be increased so that they can share information quickly with regulators without breaching client confidentiality guidelines.

E. Accounting and valuation problems arising during privatization

59. Privatization exercises are being undertaken worldwide. They are particularly numerous in developing countries and countries in transition. Last year the Group reviewed the various motivations that underlie privatization. Within the context of these exercises, many accounting problems have arisen. Therefore, the Group decided to take up this issue for

the purpose of not so much discussing international standards as identifying solutions to those problems. Very often accounting information is so deficient in some enterprises that it is impossible to draw up commercial balance sheets and income statements for interested buyers. More important, there is often little relationship among the book value of the assets, the value of the enterprise as a going concern and its sales price. It is particularly difficult to value assets that have never been valued before or that are not for sale, such as land. In many cases the situation is complicated by the introduction of new accounting concepts such as that of intangibles. For example, it is hard for accounting experts in countries in transition to deal with goodwill, particularly where there is a large divergence between the value of the enterprise as a going concern and the sales price. There is even a reluctance to undertake a thorough valuation of enterprises to be privatized where such valuation would slow down the privatization process. In some cases speed has become the overriding priority. Where the goal is complete divestiture as soon as possible, valuation and equity considerations are neglected. Eventually inadequate valuations result in political and social problems when citizens charge that the exercises have been neither transparent nor fair. Hyperinflation can also render unadjusted financial statements meaningless. There are also a number of problems regarding information disclosure. Prospectuses are often inadequately prepared for first-time or unsophisticated investors. In countries in transition information could be given comparatively, using the old, familiar formats as well as the new accounting ones. Regarding post-privatization information, special-purpose reports might be necessary for a limited time in order to let interested parties know that the exercise's original objectives have been achieved.

III. ACTIVITIES OF INTERNATIONAL AND REGIONAL ORGANIZATIONS

60. The following section is a review of the activities of international and regional organizations in the area of standard-setting and accountancy development.

A. International Accounting Standards Committee (IASC)

61. Much of the work of IASC involving its project to reduce accounting diversity has been discussed in section one. Additional information is provided below regarding its other ongoing projects.

Cash flow statements

62. Exposure draft 36, Cash Flow Statements, was published in July 1991 and is open for comment until December 1991.

63. E 36 proposes that enterprises should present a cash flow statement in place of a statement of changes in financial position. The cash flow statement should report the inflows and outflows of cash and cash equivalents

during the period. These cash flows should be classified by operating, investing and financing activities. E 36 encourages users to report cash flows from operating activities using the direct method. Under this method, an enterprise reports the gross cash receipt or payments arising from each operating activity. E 36 proposes that an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. However, E 36 recognizes that gross reporting is not relevant for some of a financial institution's activities.

64. Investing and financing transactions that do not require the use of cash and cash equivalents, such as conversion of debt to equity, should be disclosed outside the cash flow statement.

65. E 36 proposes the disclosure of the components of cash and cash equivalents and a reconciliation of these amounts with the equivalent items in the balance sheet. It also proposes specific classification and disclosure requirements for unusual items, interest and dividends, taxes on income, and acquisitions and disposals of subsidiaries or other businesses. While many financial valuation models currently focus on various forms of cash flow, the cash flow has its limitations as a measure of value changes. The focus on cash flows results from perceived misgivings with reported net income and balance sheet measures in many countries. Yet a cash flow statement, while useful as a basis for evaluating liquidity constraints, has its own set of measurement problems and can be easily manipulated from period to period. The measurement and interpretation are particularly acute in transnational corporations, as cash flows of foreign subsidiaries have to be translated at the exchange rate on the date of each transaction before inclusion in the consolidated statements.

Intangibles

66. In November 1990, the IASC Board identified further issues on intangibles for consideration by the Steering Committee. It is likely that the Board will reconsider the project again in 1992.

Earnings per share

67. The Board approved a point outline in November 1990. It has asked the Steering Committee to prepare a statement of principles, which will probably be distributed in mid-1992. The statement of principles will propose that enterprises with publicly traded ordinary shares should disclose basic and fully diluted earnings per share and will include definitions of ordinary shares outstanding and earnings and provide guidance on the calculation of both basic and fully diluted earnings per share.

Conference

68. In June 1991, IASC organized, together with the Fédération des experts comptables européens (FEE), a conference of the representatives of standard-setting bodies in over 20 countries to discuss the objectives and concepts

underlying financial statements. Various ideas were put forward for further cooperation between IASC and standard-setting bodies and the conference will probably be followed by another in the near future.

B. International Federation of Accountants (IFAC)

69. The recurring work programme of IFAC is carried out by the Council and its five major standing committees: Education, Ethics, Financial and Management Accounting, International Auditing Practices and Public Sector.

70. During the year, the IFAC Council and committees and subcommittees held 38 meetings throughout the world.

71. The Education Committee continued its efforts to monitor developments in professional education. Given the changes in make-up of the pool of human resources that the profession can reasonably expect to recruit, the Committee undertook a major consolidation of existing guidelines related to pre-accreditation education. Aside from the mechanical process of consolidation, the Committee also made a significant reassessment of content, and the result is a comprehensive - and more efficient - guideline. In future stages the Committee will address post-qualification education issues. Other significant projects have been the Committee's efforts to produce a guideline on the teaching of ethics, a subject whose international demand increases each year, and a discussion paper on "Education of the Accountant in the Year 2000 - and Beyond".

72. With a comprehensive Guideline on Ethics for Professional Accountants now in place, the Ethics Committee is concentrating on refining that document, especially as it relates to the International Organization of Securities Commissions (IOSCO). IOSCO acknowledges the Ethics Committee's role as the sole international organization that has dealt with cross-border issues and suggested certain modifications. Among its revisions, all of which were responsive to IOSCO concerns, was additional guidance on interests in non-clients, former partners and litigation issues. The Ethics Committee has also worked closely with the Education Committee on the exposure draft Professional Ethics for Accountants, the Educational Challenge and Practical Applications. Future direction will emphasize monitoring ethical developments throughout the world and involving the Ethics Committee in specific issues where an international perspective is needed.

73. With more than half of IFAC's membership not in public practice, a key focal point for this group is the Financial and Management Accounting Committee (FMAC). Among the more significant projects addressed during the year were:

(a) The cost of capital, its elements and how they are applied in practice;

(b) Management control of projects, a subject particularly important for the question of accountability and controls, which has taken on such an international character;

(c) Corporate financial performance, with the object of providing ideas on the various ways that performance can be measured.

74. The International Auditing Practices Committee (IAPC) continued its standard-setting agenda and the following documents were released:

(a) Two related services (RS) guidelines dealing with engagements to perform agreed-upon procedures and engagements to compile financial information (as the range of services expands beyond the traditional attest function, these guidelines will be particularly useful);

(b) Revisions and addenda to existing guidelines on analytical procedures and audit evidence, in response to specific concerns.

75. In a very significant move just after year-end, the Committee agreed that guidelines would be renamed international standards on auditing. The Committee felt that the term standard more appropriately describes IFAC's authority as an international standard-setting body and should also improve user perception of the status of documents and encourage wider use of those documents. The Committee also authorized a substantial codification and reassessment of the existing standards, commensurate with the upgrading of status. As a first step in this process, a topical index, following the audit process, was approved.

76. The youngest IFAC committee, the Public Sector Committee (PSC), had completed five years of existence. The public sector is a significant part of the economy, particularly in the developing world, yet developing countries often do not have sufficient resources to address the problem of accounting by public institutions. The Committee issued one guideline on Applicability of International Standards on Auditing to Audits of the Financial Statements of Government Business Enterprises, a very important study entitled "Financial reporting by national Governments" and a Selected Bibliography of Public Sector Accounting and Auditing Material.

77. IFAC accelerated its efforts as a spokesman for the international profession, particularly through such international organizations as:

(a) The International Capital Markets Group (ICMG) (co-founded by IFAC in 1989), which produced several papers on regulatory issues. IFAC contributed to those papers and also finally produced a draft on harmonized accounting standards that will be the basis for a more extensive study on the effects of different standards on the cost of capital. IFAC is particularly pleased to be taking the lead in this very worthwhile undertaking;

(b) The International Organization of Securities Commissions (IOSCO), which, while ICMG represents the private sector, represents the government

regulators of exchanges. IFAC has stepped up its efforts to win acceptance of IFAC auditing and ethics pronouncements for multinational securities offerings. The differences that existed have been minimized and both IFAC and IOSCO have an objective of a mutually acceptable set of standards, to be reached in October 1992, about the time of the World Congress of Accountants;

(c) The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, with which IFAC participated actively in March 1991, at its ninth plenary session; in February 1991, at a special conference held in Moscow designed to familiarize Soviet accountants with the international accountancy profession and IFAC's standards; in mid-October 1991, at its International Conference on Accountancy Development in Africa, held in Dakar; and in late October 1991, at the meeting of the International Task Force on Improvements in Accounting for Enterprises in the USSR, held in Moscow.

C. Working Group on Accounting Standards (OECD)

78. In 1991, the OECD Working Group on Accounting Standards, under the Partners in Transition (PIT) programme of the OECD Centre for Cooperation with European Economies in Transition, extended technical assistance to countries in transition in a number of ways:

(a) The proceedings of the OECD seminar on accounting reform in Central and Eastern Europe, which was held in Paris in September 1990 with the participation of Czechoslovakia, Hungary, Poland and the USSR, was published by the OECD Centre for Cooperation with European Economies in Transition;

(b) In July 1991, experts from the Working Group on Accounting Standards met with officials of the Czech, Slovak and Federal Ministries of Finance in Prague to discuss a draft accounting law, as well as a proposal of the Czech National Council concerning auditors and their activities;

(c) Following an invitation by the Hungarian Ministry of Finance, the OECD organized a Workshop on the Valuation Aspects of Privatization, which took place in Budapest in November 1991. In addition to looking at the specific accounting treatment of fixed assets and current assets, the Workshop focused on the issue of business valuation. The presentations made during the Workshop will be published early in 1992 as part of the Centre's series on Central and Eastern Europe.

79. The OECD Working Group on Accounting Standards continued in 1991 to address issues promoting international harmonization of accounting standards and practices. It examined a working document on the mutual recognition of financial statements and agreed that wider acceptability of the principle of mutual recognition of financial statements was not incompatible with the seeking of greater harmonization and comparability.

80. A Round Table of Intangible Assets, highlighting the accounting discrepancies resulting mainly from different national approaches and treatment of intangible assets, was held in Paris in March 1991. The proceedings of this Round Table, together with a survey of the practices in this area of member countries, will be published in 1992.

D. European Community (EC)

81. In 1991, the Commission of the European Communities asked its Accounting Advisory Forum to address the following accounting topics:

(a) Foreign currency translation;

(b) Accounting for government grants;

(c) Accounting for lease contracts.

82. Those topics were discussed at two meetings of the Forum based on working documents that aim at a further harmonization of accounts in the European Community.

83. In September 1991, a common position by the Council of Ministers and the Commission was reached on the amended proposal for a directive on the annual accounts and consolidated accounts of insurance undertakings. The directive is now to be discussed again in the European Parliament. Adoption is expected in early 1992.

E. Confederation of Asian and Pacific Accountants (CAPA)

84. The CAPA Accounting Education Project originated at the 1984 Asia Pacific Conference on Accounting Education for Development, which was held in Manila and supported by the Asian Development Bank (ADB) and the World Bank. IFAC and CAPA were significant participants in the Conference and the importance of accounting-related skills in the process of social and economic development was fully recognized. Since then IFAC has promulgated guidelines for the training of accounting technicians (International Education Guideline (IEG) 7), and ADB, in association with CAPA, has developed teaching resource materials to support the IFAC guidelines. Preliminary work has also been undertaken to assess the need for developing a regional accounting education resource centre. After prolonged discussions between ADB and CAPA and among CAPA Executive Committee members, early in April CAPA prepared and submitted to ADB the application for funding the Accounting Education Project, Phase II, which will be an in-depth feasibility study of a regional accounting education resource centre for the Asian and Pacific Region. The total estimated cost of this project is presently being assessed by the Asian Development Bank, and is expected to be around $385,000.

F. Eastern, Central and Southern Africa Federation of Accountants (ECSAFA)

85. ECSAFA was created in September 1990 to coordinate the development of the accountancy profession and to promote internationally recognized standards of professional competence and conduct in the region. The Federation is responsible for:

(a) Providing encouragement for and assistance with the formation and development of national accountancy bodies;

(b) Exchanging information on technical and professional matters between member bodies;

(c) Holding of congresses, seminars and assemblies for the accountancy profession;

(d) Communicating with IFAC and other regional organizations.

This new regional body encompasses 18,000 accountants from Ethiopia, Kenya, Malawi, Mauritius, Namibia, South Africa, Swaziland, Uganda, the United Republic of Tanzania and Zimbabwe. IFAC has suggested that ECSAFA widen its membership to cover other countries. The President of ECSAFA recently discussed accountancy problems in the region. He said:

> "The basic issue facing our profession in this region is one of numbers. There are simply not enough accountants in our region. This problem is not peculiar to Africa, but is perhaps as usual, more acute here. The numbers are obviously dependent on the trainees joining the profession and the training facilities available to them. We need to explore the training facilities we have in our region and how they could be harnessed and developed to meet our expectations. ... After training comes examination ... Some countries are totally self-sufficient and others use examination papers set elsewhere ... We need to examine ways and means of eliminating our dependency on foreign examinations. ... Do we know how many accountants are needed in each State to satisfy demand? Can we develop relevant training methods? What is the major cause of failure among our students and what should be done to improve the pass rate? Before we can expect help from others, we must demonstrate that we appreciate the important issues that confront us and are prepared to tackle them with whatever limited resources we may have." 19/

G. Fédération des experts comptables européens (FEE)

86. FEE's second conference took place in Venice from 10 to 12 October 1991. Its theme was "The process of liberalization in Europe: the role of the accountancy profession". Subjects dealt with included the harmonization of financial reporting practices, the mutual recognition of professional qualifications, privatization, concentration of enterprises and the transition

of the countries of Central and Eastern Europe from centrally planned to market economies.

FEE Survey

87. The 1992 Survey examines the accounting and reporting practices of 441 companies from 15 countries. It is not limited to large multinational corporations but also includes smaller, often family-owned, national enterprises that traditionally receive less publicity. The objectives of the survey are to highlight the problems connected with improving harmonization of accounting practices in Europe and to show how practices have developed.

88. The Survey covers a wide range of subjects, ranging from the more familiar areas, such as tangible fixed assets, financial fixed assets, inventories and government grants, to the more controversial ones, such as goodwill, brands, marketable securities, foreign currency translation and complex financial instruments. The Survey also examines other subjects such as pension provisions, deferred taxation, off-balance-sheet commitments and leasing.

89. The Survey presents a number of important conclusions. There are differences between the accounting policies and presentation of listed companies compared with those of unlisted companies. On an aggregate basis for all countries surveyed, listed companies disclose more detailed information than unlisted ones. Surprisingly, perhaps, the Survey shows that it cannot usually be said that listed companies tend to adopt accounting policies that have a favourable impact on reported profit, although in general those companies deduct goodwill from reserves, capitalize brands more often and display a greater use of revaluation.

90. Many will be interested to learn that according to the Survey, there is a growing tendency among companies in some countries (where the application of article 29 of the Seventh Directive makes possible the use of accounting policies in the consolidated accounts that are different from those used in the individual accounts) to use internationally harmonized accounting policies in consolidated accounts rather than in individual accounts. This tendency plays an important role in those countries such as Germany and France where individual accounts are used for tax purposes and the accounting and valuation methods are thus strongly influenced by legal and taxation requirements. Progress towards the improvement of the comparability of financial information may therefore lie with the consolidated accounts rather than with the individual accounts.

Central and Eastern Europe

91. Arrangements are being made for a FEE project to develop accounting and auditing practices in Bulgaria. The related contract has now been signed with the Poland and Hungary Assistance for Economic Restructuring (PHARE) operational service of the Commission of the European Communities, whereby EC funding of ECU 2.63 million (2.63 million European currency units) will be

made available. The technical assistance contract will run for an initial period of 18 months, renewable. On 24 and 25 October, FEE organized, in conjunction with the Council of Europe, a conference in Budapest, on the role of the accountancy profession in a market economy that was attended by approximately 400 participants, including several senior officials from the Hungarian ministries of finance and justice. FEE also cooperated with the OECD in organizing a conference on the accounting aspects of privatization, held in Budapest from 13 to 15 November 1991.

92. The Federation is very conscious of its obligation to help, in whatever way possible, the emerging accountancy profession and professional bodies in Central and Eastern Europe, but also aware of the need to maintain very strict criteria for full membership of FEE. Accordingly, at its October meeting, the Council approved the creation of a task force to make recommendations, inter alia, on a possible intermediate category of membership suitable for organizations in Central and Eastern Europe, until such time as they reach the standards expected of FEE members in fully developed market economies.

Mutual recognition of professional qualifications

93. FEE continues to monitor the implementation of the EC Directive on the Mutual Recognition of Professional Qualifications, which will have considerably increased geographical coverage when the European Economic Area agreement enters into force on 1 January 1993. FEE also continues to press for additional legislation to extend the benefits of the Directive to firms and to the cross-border provision of services. The need for specific provisions in this regard has been highlighted by a case currently before the EC Court of Justice, in which the obligation to be established in a country in order to provide regulated accountancy services in that country is being challenged. Given that regulation of the profession is normally founded on establishment-based, host-country control, alternative arrangements need to be laid down to cope with cross-border provision of regulated services by professionals not resident in the country of their clients.

H. Fédération internationale des experts-comptables francophones (FIDEF)

94. During 1991, the members of FIDEF engaged in a number of accountancy development activities. Algeria passed Law No. 91-08 on 27 April 1991 creating the national Ordre des Experts-comptables. In Morocco the National Accounting Council replaced the National Commission on Accounting Standards, which had formulated the general code of accounting standards. The Government also adopted a decree authorizing the national commercial and business schools to grant a diploma of certified accountant (Decree No. 2.90.545, 18 January 1991).

95. FIDEF organized, together with the United Nations Centre on Transnational Corporations (UNCTC), the International Conference on Accountancy Development in Africa, held in Dakar from 14 to 17 October 1991. The Conference attracted

over 100 participants from 26 countries. For the first time many presidents and vice-presidents of national accounting councils, directors of accounting training and international aid representatives gathered in one place to discuss accounting development. During the course of the Conference a number of themes were discussed, including:

(a) Significance of international accounting activities for developing countries;

(b) Activities of international accounting bodies and organizations such as ISAR, IFAC, the World Bank and the International Labour Office;

(c) Accounting needs in Africa: challenge of the 1990s.

96. Most important, 23 technical assistance projects in the areas of accountancy training, development of the profession and standard-setting were vetted. These projects will be revised and presented to potential donors by FIDEF and UNCTC during 1992.

I. Interamerican Accounting Association (IAA)

97. The XIX Interamerican Accounting Conference, which was held in Buenos Aires in October 1991, convened some 1,400 participants with about 300 companions, for a grand total of over 1,700 people. The assembly elected a new Executive Committee for the period 1992-1993. The countries on the new Executive Committee and their representatives are Canada (Robert Gowan), Puerto Rico (Jorge Aponte), Argentina (Hector Traballini), Brazil (José Ismar da Fonseca), El Salvador (René Fernandez), Peru (Víctor Vargas) and the Dominican Republic (Genaro Soriano). At its first meeting, the new Executive Committee ratified Mr. Robert Gowan as its President for 1992-1993 and elected Mr. Jorge Aponte as the new Deputy President.

98. Regional seminars were held in Paraguay (May), Peru (July), Chile (August), Haiti (September), and Nicaragua (October). Several IAA sponsored training sessions for executives were held. These dealt with accounting, computers, finance, inflation and teaching methods. IAA emphasis this year has been on the struggle against fraud and corruption. In Miami, Florida, on 2 and 3 December 1991, IAA hosted a tele-conference (RESPONACON) on corruption in government that was broadcast by satellite to all of Latin America on the morning of both days. After their presentations, participants-by-satellite in all countries were able to send in questions by telephone or fax. The afternoon sessions were used for local presentations in each country on corruption-related topics.

Notes

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3/ International Organization of Securities Commissions, "Comparative analysis of disclosure regimes", unpublished conference paper, Montreal 1991.

4/ Goldman Sachs International, Ltd., Anatomy of World Markets (London, 1991).

5/ World Investment Report, 1991: the Triad in Foreign Direct Investment (United Nations publication, Sales No. 91.II.A.12).

6/ See International Accounting and Reporting Issues: 1991 Review (United Nations publication, Sales No. E.91.2.A), chap. I, for a summary of the new accounting treatments.

7/ F. Choi, "Accounting and control for multinational activities: perspective on the 1990s", Management International Review, vol. 31 (special issue 1991).

8/ Securities and Exchange Commission, "Multijurisdictional disclosure and modifications to the current registration and reporting system for Canadian issuers" (49 SEC docket 0267).

9/ Remarks by Geoffrey Fitchew, Director-General of the Directorate-General XV of the Commission of the European Communities at the IASC/FEE Standard-Setting Bodies Conference, 17 and 18 June 1991, Brussels.

10/ Reply of the United States of America to the 1991 note verbale of the Secretary-General.

11/ P. J. Stilling, "The recognition and measurement of intangible assets", Round Table on Intangible Assets (Paris, OECD, May 1991).

12/ D. C. Damant, "The information needs of investors and financial analysts", Round Table on Intangible Assets (Paris, OECD, May 1991).

13/ S. J. Gray, "Summary of questionnaire responses", Round Table on Intangible Assets (DAFFE/IMF/NC/IA (91)3, Paris, OECD, May 1991).

14/ D. Rubenstein, "Lessons of love", CA Magazine (March 1991).

15/ Investor Responsibility Research Centre, "Inside the 10K", Investor's Environmental Report (winter 1991).

Notes (continued)

16/ Price Waterhouse, "Environmental accounting: the issues, the developing solutions: a survey of corporate America's accounting for environmental costs" (1991).

17/ "Environmental accounting for sustainable development" (A/CONF.151/PC/89).

18/ J. Redwood, "Regulators of the world unite: you have nothing to loose but your claims", XVI Annual Conference of the International Organization of Securities Commissions (Washington, D.C., 25 September 1991).

19/ "Towards more regional cooperation", ECSAFA inaugural speech (September 1990).